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E.O. 12958: DECL: 09/18/2016  
TAGS: [ETRD](#) [ENRG](#) [EPET](#) [UP](#)  
SUBJECT: UKRAINE: A/S FRIED'S DISCUSSIONS OF ECONOMIC  
TOPICS: WTO, ENERGY, REFORM

REF: A. KIEV --- [YANU CABLE]  
[1](#)B. KIEV 2804

Classified By: Ambassador, reason 1.4 (b,d)

[1](#)1. (C) Summary: Speaker of Parliament Moroz told A/S Fried the parliament (Rada) had begun work on remaining WTO legislation, but notably made no predictions about when it would pass. Opposition leader Tymoshenko, on the other hand, expected Yanukovych's government to significantly slow down the WTO accession process. On gas, prominent journalist Yuliya Mostova expressed concerns that Ukraine might focus on low prices to protect industrialists' interests, to the detriment of other national interests. She highlighted the geo-strategic threat if Russia gained control of Ukraine's gas markets and infrastructure. Speaker Moroz, however, felt gas negotiations with Russia were going well. Yanukovych himself showcased the role of Western advice in his economic program, in which he had a strong focus on business tax reductions. End Summary.

#### WTO ACCESSION

[1](#)2. (C) In A/S Fried's discussion with Speaker Oleksandr Moroz September 7, Moroz reported that the Cabinet of Ministers had already submitted a series of WTO draft laws to the Rada. The Committees were now working hard on the laws because they are not simple for the Ukrainian economy. There was the desire among the Ukrainian leadership to accede to WTO, Moroz noted, but accession would be hard for Ukraine. Ukraine needs to be careful to make sure accession didn't adversely affect trade or production. A/S Fried said he was pleased that the bilateral was concluded, he hoped the legislation would pass, and reassured Moroz that accession would be positive for the Ukrainian economy, so don't let protectionist influences stop this progress.

[1](#)3. (C) Comment: Moroz's comments echoed those Yanukovych made on Tuesday in his speech to the Rada and hinted at the possibility of a slow down in progress. There was no target date for accession mentioned. Moroz's take on WTO today differed from his July meeting with the Ambassador, when he said he strongly supported WTO accession because it was good for Ukraine, although he raised concerns about Russian accession at that time (see ref b).

[1](#)4. (C) Opposition leader Yulia Tymoshenko predicted to Fried that Yanukovych would slow down WTO. Regions, she stated, would slow Ukraine's progress toward WTO membership once it gained over 300 deputies for the coalition. Tymoshenko noted that, in his September 5 speech to the Rada, Yanukovych had said Ukraine should address its membership in WTO "calmly, without haste, and taking into consideration the interests of domestic producers." In plain language, Tymoshenko commented, Yanukovych was saying the process of WTO accession would be dragged out "endlessly."

## GAS AND POLITICS

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15. (C) Yuliya Mostova, Ukraine's leading political journalist, suggested that Yanukovych would have little opportunity to renegotiate the gas deal with Russia. Energy Minister Boiko initially took a tough position in early August with the Russians, but something changed during the month, and Boiko and his ministry seem to be taking instructions from Regions financier Rinat Akhmetov, though the two never were close in the past. Akhmetov's personal business interests were in securing as low a gas price as possible, which could come to the detriment of Ukraine's national interests, since he would trade political concessions for cheap gas. Mostova felt Ukraine needed expensive gas in order to become independent. Even at \$95/tcm, the Ukrainian chemical industry was heading towards bankruptcy, leading Gazprom to negotiate with individual firms, offering lower gas for equity. (Comment: Although higher gas prices have reduced margins and profits at Ukraine's chemical companies, published financial reports so far do not suggest the situation is quite as dire as Mostova states.)

16. (C) The Donetsk clan was attempting to impose its control over the entire economy, but the energy and fuel industry for now was not a single integrated entity, Mostova said. Boiko had tried to bring NaftoHaz under his control, but the head of NaftoHaz said that he would answer to the PM only. NaftoHaz had ceased to be profitable. Having delivered 10 billion hryvna (\$2 billion) to the state budget in 2005, it had gone 15 billion hryvnia in the hole in 2006. Partly that was because it no longer controlled domestic gas

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distribution; RUE and the new joint venture did. Partly it was due to looting by former NaftoHaz chief Ivchenko. After becoming PM, Yanukovych invited SBU Chief Dryzhchany to explain what the SBU had done since last September to prevent the theft of 13.2 billion hryvnia (\$2.6 billion) from Naftohaz' assets. Mostova noted that under Kuchma, Naftohaz had a reliable structure contributing to the state budget, even if Kuchma demanded a 5% cut which netted him \$300 million. "There's a difference between corruption and looting," said Mostova, "and Ivchenko demonstrated the difference between a nationalist and a patriot."

## GAS: THE STRATEGIC ELEMENT

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17. (C) Mostova and her husband DefMin Hrytsenko stressed the geostrategic threat posed by Russia's gas diplomacy. If Gazprom/RUE were to conquer Ukraine, it would enjoy unchecked control over Europe. The U.S. understood this reality much better than western Europe; what Ukraine needed was for U.S. energy companies to become involved in the process, such as realizing the idea floated by former Economics Minister Yatseniuk of forming a new international consortium to manage an additional pipeline which could be built. A/S Fried stressed that the U.S. was supportive of any new projects that were transparent and commercially viable; the key was to engage U.S. industry players.

18. (C) Mostova claimed that after Moscow raised the price of gas to Belarus, Belarusian President Lukashenko had begged Yushchenko to work together against Russian pressure on gas, leveraging their common transit grip on Russia, but that Tarasyuk had convinced Yushchenko to rebuff Lukashenko out of fear of the U.S. reaction. A/S Fried noted that Lukashenko was unpredictable and increasingly desperate.

19. (C) Speaker Moroz, on the other hand, argued gas negotiations with Russia were proceeding well. Russia's decision to raise gas prices was not a political decision, he claimed. Ukrainian agreement on gas prices would add a new

economic aspect to foreign policy -- Ukraine would be seen as a sovereign and independent country. There were ongoing Ukrainian government consultations on how to reduce energy dependence on Russia, which was a good sign for Ukrainian foreign policy. A/S Fried said that he was glad Ukraine was working on decreasing energy dependence on Russia, but Russia would always be a major supplier. The key was that energy relations be based on transparency and market principles, not the interests of a small group of people.

YANUKOVYCH: STUDENT OF WESTERN REFORMS?

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¶10. (C) In addition to his comments in ref a, PM Yanukovych highlighted to A/S Fried his plans for Ukraine's development up to 2011. The consultancy McKinsey was helping the GOU, and Yanukovych felt McKinsey's experience in other CIS countries was applicable to Ukraine, with some modifications. Yanukovych also claimed his government was closely studying recommendations of the World Bank, which he stated were largely in line with his government's basic line. (Comment: We interpreted Yanukovych's repeated citing of McKinsey and the World Bank as an attempt to establish his economic bona fides with us.)

¶11. (C) While he bewailed the UAH 6 billion (approximately USD 1.2 billion) budget deficit he had inherited, Yanukovych specifically focused on reducing the business tax burden. He promised to repeal an indirect 7 percent tax on manufacturers that resulted in declining production and thus cut budget revenues. Similarly, he argued that the previous government had forced state monopolies to increase their contributions to the budget by 25 percent, and the state monopolies had in turn financed this by increasing rates for business, so business was really paying. Yanukovych said he would end this squeezing of state monopolies, so they in turn could reduce rates. (Comment: We expect rail freight rates would be a key item among the state monopolies.)

¶12. (U) A/S Fried has cleared this cable.

¶13. (U) Visit Embassy Kiev's classified website at:  
[www.state.sgov.gov/p/eur/kiev](http://www.state.sgov.gov/p/eur/kiev).  
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